

# **Engcobo Municipality**

## **Audit Report**

For the year ended 30 June 2013

# REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND COUNCIL ON THE ENGCOCO LOCAL MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the financial statements of the Engcobo Local Municipality set out on pages ... to ... , which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and the cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting officer's responsibility for the financial statements

2. The accounting authority is responsible for the preparation and fair presentation of these consolidated and financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Engcobo Local Municipality as at 30 June 2013, and its financial performance and cash flows for the year then ended in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

### Emphasis of matters

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of comparative figures**

8. As disclosed in note 40 to the financial statements, the comparative figures for 30 June 2012 have been restated as a result of errors only corrected during the year ended 30 June 2013 that existed in the financial statements at, and for the year ended, 30 June 2012.

### **Unauthorised and irregular expenditure**

9. As disclosed in note 43 and 45 to the financial statements, R60,4 million of unauthorised expenditure and R3,5 million of irregular expenditure respectively, was incurred during the financial year.

### **Material losses/impairments**

10. As disclosed in note 29 to the financial statements the debt impairment amounted to R3,6 million for the year under review.
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## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

11. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

### **Predetermined objectives**

12. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
13. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury Framework for managing programme performance information (FMPPI).
14. The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete). The material findings are as follows:

### **Usefulness of information**

#### **Presentation**

15. Section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Adequate and reliable

corroborating evidence could not be provided for all measures taken to improve performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures.

16. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the reliability of the measures taken to improve performance.

### **Consistency**

17. The Municipal Systems Act (MSA), section 41(c) requires that the integrated development plan (IDP) should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. There were material inconsistencies between planned and reported performance information and in-year changes to material indicators and targets that were not submitted for approval to council.

### **Measurability**

18. The National Treasury FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 35% (17 out of 48) of the indicators for Basic Service Delivery objectives were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to a lack of proper review when indicators and targets were decided on and formulated for inclusion in the IDP.
19. The National Treasury FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 35% of the targets relevant to Basic Service Delivery. This was due to a lack of proper review when indicators and targets were decided on and formulated for inclusion in the IDP.

### **Reliability of information**

#### **Validity and Accuracy**

##### **Reported performance not valid or accurate**

20. The National Treasury FMPPI requires that processes and systems which produce the indicator should be verifiable, and that the indicators be accurate enough for its intended use and respond to changes in the level of performance. A total of 100% of the actual reported performance relevant to Basic Service Delivery were not valid and accurate when compared to the evidence provided. This was due to the limitation placed on the scope of my work owing to the absence of information system at the auditee for the collection of performance information against what is reported at year end. In addition, this was due to a lack of monitoring by senior management, an inadequate review process to verify all supporting evidence before the performance report was submitted for audit, as well as a lack of standard operating procedures that are in line with the requirements of the FMPPI for the recording of actual achievements. Furthermore this was due to lack of non-implementation of processes for collection of corroborating evidence.

### **Completeness**

#### **Reported performance not complete**

21. The National Treasury FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain all information I considered necessary to



satisfy myself as to the completeness of actual reported information. This was due to inadequate processes in existence for data collection to support reported performance information. Therefore, source information for 100% of the actual reported performance relevant to Basic Service Delivery could not be substantiated with sufficient audit evidence. .

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### **Compliance with laws and regulations**

22. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

### **Strategic planning and performance management**

23. The performance management system of the municipality did not provide for the monitoring of performance and for the measuring and review of performance and for the measuring and review of performance at least once per year, with regard to each of the development priorities and objectives and against the key performance indicators and targets set as required by section 41 of the Municipal Systems Act.
24. The performance management system of the municipality did not provide for taking steps to improve performance with regard to those development priorities and objectives where performance targets are not met as required by section 41(1) (d) of the Municipal Systems Act.
25. The audit committee did not review the municipality's performance management system and make recommendations to the council], as required by Municipal planning and performance management regulation 14(4) (a) (ii).
26. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4) (a) (i).
27. The internal audit unit did not assess the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal planning and performance management regulation 14(1) (b) (iii).
28. The internal audit unit did not audit the performance measurements on a continuous basis and submitted quarterly reports on their audits to the municipal manager and the audit committee, as required by Municipal planning and performance management regulation 14(1)(c).
29. The annual performance report for the previous financial year was not included in the annual report, as required by section 46 of the MSA and section 121(3)(c) of the MFMA
30. The annual performance report for the year under review does not include the performance of each external service provider as required by section 46(1) (a) of the MSA.
31. The annual performance report for the year under review does not include a comparison with the previous financial year as required by section 46(1) (b) of the MSA.

32. The annual performance report for the year under review does not include measures taken to improve performance, as required by section 46(1)(c) of the MSA
33. The municipality did not conduct its affairs in a manner which was consistent with its integrated development plan as required by section 36 of the Municipal Systems Act and municipal planning and performance management regulation 6.

#### **Budgets**

34. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.
35. Monthly budget statements were not submitted to the mayor and the relevant provincial treasury on the within 10 days after the end of each month, as required by section 71 (1) and 81(1) of the MFMA

#### **Annual financial statements, performance and annual report**

36. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
37. Material misstatements of non-current assets, irregular expenditure and unauthorised expenditure identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

#### **Procurement and contract management**

38. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
39. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2)
40. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
41. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
42. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
43. Awards were made to providers who are persons in service of other state institutions, in contravention of SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

#### **Expenditure management**

44. The accounting officer did not take effective steps to prevent unauthorised expenditure and irregular expenditure, as required by section 62(1) (d) of the MFMA.
45. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred , accounted for creditors and accounted for payments made as required by section 65(2)(b) of the MFMA.

### **Revenue management**

- 46. An adequate management, accounting and information system was not in place which recognised revenue when it was earned, accounted for debtors or accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.
- 47. Interest was not charged on all accounts in arrears as, required by section 64(2) (g) of the MFMA.

### **Conditional grants**

- 48. Sufficient appropriate audit evidence could not be obtained that unspent conditional grant funds were committed to identifiable projects or were approved by the National Treasury for retention as they were not surrendered to National Revenue Fund, as required by section 20(1) of the Division of Revenue Act.
- 49. The municipality did not submit all project registration forms, for projects to be implemented in 2013/14, to the provincial department of local government by 1 August 2012, as required by DoRA Grant Framework, (Gazette no 35399).
- 50. The municipality did not submit its detailed project implementation plan for projects to be implemented in 2013/14 and 2014/15 financial years, to the national department (CoGTA) as required by DoRA Grant Framework, (Gazette no 35399).
- 51. The municipality did not evaluate its performance in respect of programmes funded by the allocation and did not submit the evaluation to the transferring national officer as required by DoRA Grant Framework, (Gazette no 35399).
- 52. The municipality did not submit its signed activity plan in the prescribed format to the national department (CoGTA) as required by DoRA Grant Framework, (Gazette no 35399).
- 53. The municipality did not submit its monthly expenditure reports within 10 days after the end of each month as required by DoRA Grant Framework, (Gazette no 35399).

### **Asset management**

- 54. An effective system of internal control for assets, including an asset register, was not in place as required by section 63(2) (c) of the MFMA.

### **Liability management**

- 55. A management, accounting and information system which adequately accounts for liabilities was not in place, as required by section 63(2) (a) of the MFMA.

### **Consequence Management**

- 56. Unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA.

### **Internal control**

- 57. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control were limited to the significant deficiencies that resulted in unqualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

- 58. There was no change in leadership, the municipality has improved from prior year to current year. Leadership stability has lead to the improvements noted. Notwithstanding



the consistency in leadership, there were shortcomings in oversight responsibilities which has resulted in a number of instances of non-compliance with laws and regulations.

59. The municipality has not implemented adequate review mechanisms to ensure that the report on predetermined objectives and the annual financial statements are reviewed for accuracy and completeness prior to submission for audit.

### **Financial and performance management**

60. The municipality remains reliant on the use of consultants to perform financial administration and reporting functions that should be performed by the staff employed by the municipality. A poor control environment over financial reporting exists as manual reconciliations of accounting records and supporting schedules are required at year end as these controls are not performed on a regular and ongoing basis during the year. Lack of monitoring, supervision and controls not being implemented, has resulted in misstatements not being identified timeously
61. The systems or processes for the preparation and reporting of performance against predetermined objectives are not adequate or sufficient.

### **Governance**

62. The municipality has an audit committee and internal audit unit in place. However, insufficient action was taken by the governance structures within the municipality during the year under review to ensure that risks relating to the monitoring and reporting of financial information, compliance and performance objectives were addressed
63. The audit committee did not advise the council and accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information which has thus resulted in a number of material misstatements identified through the audit process

*Auditor General*

East London

30 November 2013



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SOUTH AFRICA

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